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...e Court, U.S.
FILED

JAN 13 2003

OFFICE OF THE CLERK

No. 02-829

IN THE

Supreme Court of the United States

DISCOVER BANK,

Petitioner,

v.

JOHN SZETELA,

Respondent.

On Petition for a Writ of Certiorari to the California Court of Appeal, Fourth Appellate District

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

1. On January 10, 2003, this Court granted the petition for certiorari in *Green Tree Financial Corp.* v. *Bazzle*, No. 02-634, which asks "[w]hether the Federal Arbitration Act prohibits class-action procedures from being superimposed onto an arbitration agreement that does not provide for class-action arbitration." 71 U.S.L.W. 3320. This petition asks the related question whether the Federal Arbitration Act prohibits a court from striking a clause in an arbitration agreement that *expressly* barred class-action arbitration—thus forcing the parties to choose between arbitrating as a class or not arbitrating at all. This petition should likewise be granted, or at the least held pending resolution of *Green Tree*.

The Supreme Court of South Carolina in *Green Tree* purported to apply the "California approach" to the question

whether courts could impose class procedures on arbitration agreements that did not speak to the issue. *Bazzle* v. *Green Tree Financial Corp.*, 569 S.E.2d 349, 356 (S.C. 2002) (citing *Keating* v. *Superior Court*, 645 P.2d 1192 (Cal. 1982), *rev'd in part and dismissed in part*, 465 U.S. 1 (1984)), *cert. granted*, ___ S. Ct. ___, 71 U.S.L.W. 3320 (Jan. 10, 2003); *id.* at 357-358 (citing *Blue Cross of Cal.* v. *Superior Court*, 78 Cal. Rptr. 2d 779 (Cal. App. 1998), *cert. denied*, 527 U.S. 1003 (1999)). The California Court of Appeal decision giving rise to this petition took the "California approach" to the next level. The Court of Appeal found that a clause in an arbitration agreement prohibiting class procedures in arbitration was "unconscionable" because it contravened state policy in favor of class dispute resolution. *See* Pet. App. 8a-9a. In striking that procedural limitation on the parties' agreement to arbitrate, the court improperly modified the agreement, contravening the Arbitration Act's firm admonition that such agreements be enforced according to their terms. Where in *Green Tree* the court added terms to the parties' agreement by imposing class procedures on the arbitral proceeding, here the Court of Appeal subtracted terms from the parties' arbitral contract, leaving them with a choice—arbitrate class-wide or litigate class-wide—for which the parties had not bargained. This Court should grant certiorari in this case as well, to address and resolve this equally unlawful expansion of the "California approach."

2. Respondent "does not dispute" that the Federal Arbitration Act "governs the arbitration clause in this case." Opp. 16. Yet his principal refrain in opposition is that Discover's petition raises only a question of state law. *See id.* at 8, 9, 10, 12, 14.[1] That is demonstrably wrong.

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[1] The respondent in *Green Tree* offered the same argument in opposition to the petition for certiorari. *See Green Tree* Opp. 13 (arguing in heading I that "the state supreme court applied state law as permitted under the FAA and this Court's decisions"); *id.* at 13-18.

The Arbitration Act requires courts to enforce agreements to arbitrate according to their terms. That is its "central purpose." *Mastrobuono* v. *Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53 (1995). The California Court of Appeal invoked "unconscionability" grounds to strike the no-class-action provision in the parties' arbitration agreement. *See* Pet. 7-8, 12-13; Pet. App. 8a-9a. Its decision therefore implicates Section 2 of the Arbitration Act, requiring courts to enforce arbitration agreements "save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2; *see* Opp. 10 (quoting Section 2).

Section 2 carves out a narrow exception to the Act's command, permitting parties to resist enforcement of arbitration agreements based on generally-applicable state-law contract defenses, including unconscionability. *See Doctor's Assocs., Inc.* v. *Casarotto*, 517 U.S. 681 (1996). But a court may not invoke Section 2 to deem "unconscionable" procedural waivers specific to arbitration agreements, as the California Court of Appeal did here; the Act does not permit such glib evasions of its charge. *See Perry* v. *Thomas*, 482 U.S. 483, 493 n.9 (1987) (court "may not * * * in assessing the rights of litigants to enforce an arbitration agreement, * * * rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable"). Parties who agree to arbitrate typically give up rights associated with judicial proceedings. For example, such parties waive their constitutional right to a jury trial, among other things. *See Republic Steel Corp.* v. *Maddox*, 379 U.S. 650, 664 (1965) (Black, J., dissenting) ("arbitration carries no right to a jury trial as guaranteed by the Seventh Amendment"); *American Heritage Life Ins. Co.* v. *Orr*, 294 F.3d 702, 711 (5th Cir. 2002). Since such relinquishment is the essence of arbitration, a court may not deem it unconscionable without running afoul of Section 2 of the Act.

Respondent also claims that "[f]ederal law is simply irrelevant to the *Szetela* court's analysis under state unconscion-

ability law." Opp. 8. That is exactly what is wrong with the California Court of Appeal's decision. The federal question whether the Arbitration Act preempts state law or policy favoring class dispute-resolution procedures was directly relevant to the lower courts' inquiry, as Discover explained at every step of the proceedings below. *See* Pet. 7-9. That the Court of Appeal studiously ignored federal law in its opinion does not insulate its decision from review.[2]

In addition, appellees in *Southland Corp.* v. *Keating*, 465 U.S. 1—in which the same question presented by this petition was raised on review—offered the same "state-law" protestations respondent offers here, to no effect. When the *Southland* appellants filed their jurisdictional statement in this Court, the appellees moved to dismiss, arguing, among other things, that the case presented "no substantial federal question" because "[t]he issue as to whether the arbitration can be handled on a class action basis is purely a question of state law." Mot. To Dismiss (No. 82-500) at 9. This Court nonetheless took up the issue, dismissing it only when it became apparent at the merits stage that the federal question presented had not adequately been raised below.[3] This Court should be similarly unswayed by respondent's arguments that the California Court of Appeal's decision implicates only state, and not federal, law.

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[2] On January 7, 2003, the Court of Appeal expressly considered and rejected the argument that the Federal Arbitration Act preempted state policies favoring class proceedings. *Mandel* v. *Household Bank (Nevada)*, 2003 WL 57282 (Cal. App. 4th Dist. Jan. 7, 2003). Relying on and reaffirming its decision in this case, the court in *Mandel* severed from an arbitration agreement a provision prohibiting class arbitration without the consent of both parties. *Id.*

[3] As Discover explained in its petition (at 12), that jurisdictional bar is not present in this case, and respondent does not and cannot argue otherwise.

3. Beyond asserting incorrectly that the California Court of Appeal's decision presents a purely state-law issue, respondent has little to say. He argues that there is no "conflict" between the California Court of Appeal's decision and this Court's Arbitration Act precedents. Opp. 8. For support he relies on a handful of *district court* cases following the California minority rule. *See id.* at 10-15.[4]

Respondent does not, however, come to grips with *this* Court's decisions, nor does he even cite them. He thus never explains how the Court of Appeal's decision to superimpose the "procedural mechanism" of class proceedings on the parties' arbitration agreement—while citing policies in favor of "streamlin[ing] the litigation process," "efficien[cy]," and "judicial economy,"[5] Pet. App. 9a—squares with this Court's repeated statements that the Arbitration Act "*requires* piecemeal resolution when necessary to give effect to an arbitration agreement." *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1, 20 (1983) (emphasis in

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[4] Further, in quoting lengthy passages from the few district court cases to have followed the California rule, respondent neglects to address or explain the majority rule set forth in the host of district court decisions holding to the contrary. *See* Pet. 16 & n.6 (citing cases); *see also Primerica Fin. Servs., Inc.* v. *DiUrales*, 2002 WL 31844901 (E.D. La. Dec. 16, 2002) (compelling arbitration of individual claim where arbitration agreement did not provide for class proceedings); *Lewis Tree Serv., Inc.* v. *Lucent Techs. Inc.*, ___ F. Supp. 2d ___, 2002 WL 31619029, at *4 (S.D.N.Y. Nov. 20, 2002) (citing *Gilmer* and noting that "[f]ederal courts have * * * consistently enforced arbitration provisions in the context of class action lawsuits when federal statutory claims have been at issue"). Among those district court cases adverse to respondent, moreover, are several specifically rejecting the argument that a no-class-action provision renders an arbitration agreement "unconscionable." *See* Pet. 16 n.6.

[5] Since arbitration occurs outside the judicial context, of course, an arbitral proceeding could only *aid* "judicial efficiency."

original); *see Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213, 220-221 (1985) (admonishing courts not to allow considerations of "efficien[cy]" to "overshadow" the Arbitration Act's central purpose). Nor does respondent attempt to reconcile the Court of Appeal's holding with this Court's decision in *Gilmer* v. *Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 (1991), which compelled arbitration of claims arising under the Age Discrimination in Employment Act despite the petitioner's insistence that arbitration would eliminate his "right" to a class action.

4. Only in a footnote at the end of his opposition does respondent answer the lead-off argument in Discover's petition: that the California rule conflicts with the approach of *all* the federal circuits to have addressed the issue.[6] *See* Pet. 13-15; Opp. 15 n.6. As Discover explained in its petition, every circuit to have considered the question has held that courts lack authority to order class-wide arbitration unless the parties expressly agreed to that procedure, *see Champ* v. *Siegel Trading Co.*, 55 F.3d 269, 276-277 (7th Cir. 1995), and, relatedly, have enforced arbitration agreements where no class action procedures were available. *Snowden* v. *Checkpoint Check Cashing*, 290 F.3d 631, 638-639 (4th Cir.), *cert. denied*, 123 S. Ct. 695 (2002); *Dominium Austin Partners, L.L.C.* v. *Emerson*, 248 F.3d 720 (8th Cir. 2001); *Randolph* v. *Green Tree Fin. Corp.*, 244 F.3d 814, 817-818 (11th Cir. 2001); *Johnson* v. *West Suburban Bank*, 225 F.3d 366, 369 (3d Cir. 2000), *cert. denied*, 531 U.S. 1145 (2001).[7]

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[6] Respondent is wrong when he suggests that the Ninth Circuit has adopted the California approach. *See* Opp. 14. The panel in *Ferguson* v. *Countrywide Credit Indus., Inc.*, 298 F.3d 778, 784 (9th Cir. 2002), cited the California Court of Appeal's decision on an aspect of procedural unconscionability irrelevant to the federal inquiry here.

[7] *See also Adkins* v. *Labor Ready, Inc.*, 303 F.3d 496, 503 (4th Cir. 2002) (plaintiff's "inability to bring a class action * * * cannot

The California decision is also in conflict with the Second, Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits, all of which have concluded that the Arbitration Act precludes courts from consolidating arbitration proceedings unless the parties expressly provided for consolidation in their arbitration agreements. *See* Pet. 17 n.8.

Respondent's first answer to this sharp conflict is that the California Court of Appeal's decision does not warrant review because it is not from a state "court of last resort." Opp. 15 n.6; *see id.* at 8-9 n.2. That is just wrong. The California Supreme Court denied discretionary review of the Court of Appeal's decision, Pet. App. 11a, rendering the Court of Appeal's decision the final decision of the state courts. *See Interstate Circuit, Inc.* v. *City of Dallas*, 390 U.S. 676, 678 n.1 (1968); Robert L. Stern *et al.*, *Supreme Court Practice* 167 (8th ed. 2002) (if highest state court declines to exercise discretionary review, "the judgment of the intermediate court rather than the order of refusal by the higher court is the judgment reviewable").

Respondent next argues in his footnote that the conflict between the California approach to the Arbitration Act and that of the federal courts of appeal is actually "not a conflict," because the California Court of Appeal "did not order classwide arbitration" but instead struck the arbitration agreement's prohibition on classwide arbitration. Opp. 15 n.6. That is a totally meaningless distinction. The Court of Appeal forced the parties to choose between arbitrating as a class or not arbitrating at all. *See* Pet. i, 2, 4, 11, 13. That is not what they agreed to, and no more in keeping with *Champ*, *Randolph*, *Johnson*, *Snowden*, and *Dominium* than if the court had ordered arbitration to proceed classwide. And respondent's last assertion—that the Court of Appeal's ruling on "unconscionability" grounds eliminates the conflict

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by itself suffice to defeat the strong congressional preference for an arbitral forum").

between that court and the circuit courts, Opp. 15 n.6—is equally meritless, because it necessarily depends on the assumption that the Court of Appeal's decision was *right*. It was not. Federal law precluded the court from striking the parties' express agreement not to use class procedures in arbitration. That is the point of this petition.

5. With this Court's grant of certiorari in *Green Tree Financial Corp.* v. *Bazzle*, the national importance of the question presented in this petition is beyond serious dispute. *See also* Mot. for Leave to File Br. Amici Curiae and Br. for American Bankers Association, American Financial Services Association, Consumer Bankers Association, and Chamber of Commerce of the United States. This Court repeatedly has admonished that arbitration agreements must be enforced according to their terms. All of the federal circuit courts, the vast majority of the district courts, and a healthy number of state courts all have fallen in line with this statutorily-mandated principle, declining to impose class procedures on an arbitration in the absence of the parties' agreement. California, however, has not; and what is more, that court's fixed adherence to a pre-Arbitration Act-era suspicion of arbitral procedures has attracted a few recent followers. *See Bazzle*, 569 S.E.2d at 356-358 (analyzing and adopting "California approach" to whether trial courts may order class arbitration when the parties have not agreed to that procedure); Pet. 19 & n.9 (noting courts following California's minority view); Opp. 11-15. This Court should grant certiorari in this case as well, to resolve the deepening conflict between California's approach to the Arbitration Act's principles and that of this Court and all the federal circuit courts to have addressed the issue.

CONCLUSION

For the foregoing reasons, and for those in the petition, the petition should be granted. Alternatively, the petition should be held pending resolution of *Green Tree Financial Corp.* v. *Bazzle*, No. 02-634.

Respectfully submitted,

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